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IMPLICATIONS OF THE FINANCE ACT ON THE DIGITAL ECONOMY

Introduction

Technological changes are constantly shaping business relationships and organizations have continued to refine their business models to keep up with these digital innovations. In spite of global attempts to respond to these innovations by creating tax efficient fiscal policies, Nigeria's tax-collecting capacity is yet to improve to keep pace with this digital revolution. This article expounds the challenges facing the tax system in Nigeria in its bid to match digitalization, and the impact of the Finance Act on the digital economy in Nigeria.

The Finance Act and Taxation of Cross-Border E-Commerce

Despite being the largest economy in Africa, Nigeria is said to be one of the worst ten tax collectors in the world with a 6% tax-GDP ratio. The Nigerian Government's fall in oil earnings, which contributes the bulk of the country's income, has engendered an even weaker fiscal position which necessitated a new tax regime that will shore up Nigeria's revenue base and avoid any form of tax leakage. It was therefore not surprising when the Finance Act was enacted, which amongst other things, seeks to mitigate regressive taxation, reform tax laws to align with global best practices and raise revenue for the government. The increase of VAT from 5% to 7.5% already gives one an idea of how important raising revenue is for the government.

The introduction by the Finance Act of the new Section 13 sub-section (2) (c) into the Companies Income Tax Act (CITA) further underscores government's quest to ensure that no part of the economy, not even the highly digitalized business models of foreign entities which had hitherto not been subjected to tax in Nigeria, escapes tax liability. This new section 13 (2) (c) of the CITA amends the CITA to adapt to changing technological innovation by providing that profit from a company doing business via an electronic platform is taxable if it has Significant Economic Presence (SEP) in Nigeria. While this is laudable, it does create certain challenges in terms of implementation. One of such challenge is the fluidity and borderless market of online transaction as well as the complexity of technology that enables e-Commerce operate like a nomad, with no fixed place of business. How then will the government trace such tax liability? Is it going to levy tax against the foreign entity which derived profit from Nigeria via e-transaction? If the answer is in the affirmative, it then begs the question of how the government intends to recover such tax from that foreign entity?

Another possibility, probably a no-brainer, is the imposition of VAT on the consumer buying goods or services from a foreign entity online, which then leads to the burden of double taxation and the complexity of refunding VAT in the event the goods purchased are eventually returned. Levying VAT on the consumer purchasing goods or services online from a foreign entity seems the most practicable as same may be deducted from source, the consumer's bank account. It should however be borne in mind that the foreign entity would have charged the consumer VAT, which is expected to be paid to the foreign entity's government (not the Nigerian government). This then raises the challenge of imposition of an additional tax burden on the Nigerian consumer- I doubt if this was the mischief the Finance Act was enacted to create. It appears the Finance Act envisaged putting the Nigerian tax authority in a position to collect a share of the profit accruing to the foreign entity instead of the imposition of an addition tax burden on the consumer.

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Significant Economic Presence and Allocation of Taxing Rights.

Where the Nigerian government intends to levy tax on the profit accruing from online transaction to a foreign entity with no fixed base in Nigeria, the question of how income generated from cross-border activities in the digital age should be taxed and allocated as revenue among countries needs to be answered. Here are some examples of what these amendments and the interpretation of SEP may occasion in practice: Adobe which offers photo and document editing services for a fee to users in Nigeria would be mandated to pay taxes for profit derived from Nigeria and the same would go for every subscription based app on the various stores as well as eBay, Amazon amongst others. Significant Economic Presence (SEP) is an emerging principle in international tax law that was formulated by the Organization for Economic Cooperation and Development(OECD) Base Erosion and Profit Shifting Action Plan as part of attempts to bring the rapidly multiplying digital businesses within the jurisdiction of EU country tax nets.

Certain factors that evidence purposeful and sustained interaction with the economy of a country were proposed under the OECD to assess the minimum requirements for a non-resident company to have SEP, namely a revenue-based factor, digital-base factor, user-based factors or a hybrid of these.With obvious implementation difficulties faced by various jurisdictions such as data tracing by tax authorities and information technology expertise, the OECD has taken on the task of developing a more optimal global solution. One of such proposed solutions, emanating from the concept of Significant Economic Presence, is that, if revenue generated by a foreign company without a fixed base in another country exceeds a particular benchmark or threshold, or the volume of contracts concluded within a given month or year goes beyond a particular number, the foreign company in question will be deemed to have a taxable presence in or be liable to pay tax to the country from which such income was generated. In the interim, some countries have imposed a flat rate digital service tax on businesses based on their revenue or activities. For instance, France has imposed a 3% rate that targets businesses with annual worldwide revenue of €750 million derived from online marketplaces, digital advertising and transmission of personal data.

Conclusion

In the complex world of the digital economy, one solution creates a myriad of other problems, and in this instance of employing the SEP principle in Nigeria to levy tax on online transactions, problems such as the allocation metric used to define SEP, nexus and treaty considerations, data availability, who bears the burden of filing tax obligations and who the tax administrator will be within the Nigerian jurisdiction, will arise. It should be borne in mind that the SEP principle originated from the Eurocentric OECD where there is a legal nexus – the EU Commission and the OECD Investment Committee- that makes administration of taxing rights and revenue allocation easier, more so as it is a consensus-based proposal by the nations, mostly from the EU, constituting the OECD. Making a case for the implementation of the SEP by a non-aligned country like Nigeria might be a totally different ballgame.

The non-inclusion of a specific definition of what constitutes an SEP would appear to be a deliberate strategy to provide for flexibility in characterizing the new concept in order to enable alignment of what would constitute SEP with future evolution in business trends. This will hopefully and significantly define the evolving Nigerian digital taxation regime and allow it cope with the fast-paced effect of digital innovations.

Though the Finance Act comes to the rescue as the new Section 4 of the CITA provides that the Minister is empowered to determine what constitutes SEP, its implementation will still create some legal and administrative challenges such as the parameters that the Minister will deploy to determine or interpret SEP, allocate tax liability in the international trade space, monitor and enforce compliance, etc. These are issues that the tax payer, the consumer and probably the courts will look forward to being apprised of. Until then, and at least in the meantime, every stakeholder in the e-commerce market place now knows that it is no longer business as usual with regard to tax liability for cross-border online transactions. - **Written by Fatima Aigbomian and Oreoluwa Macaulay**

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NEWS UPDATE

RESPONSE TO COVID-19

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